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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BY HAND DELIVERY

Magalie Salas, Secretary
Federal Communications Commission
1919 M Street, Room 222
Washington, D.C. 20554

Re: In the Matter of Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, CC Docket No. 96-128

Dear Ms. Salas:

Please find enclosed for filing an original and four copies of the RBOC/GTE/SNET Payphone Coalition's Reply Comments on Remand Issues in the above-captioned proceeding.

Please date-stamp and return the extra copy provided to the individual delivering this package.

Sincerely,

Michael K Kellogg /amg

Michael K. Kellogg

Enclosures

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JUL 27 1998

FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.

In the Matter of

Implementation of the Pay Telephone	)	
Reclassification and Compensation	)	CC Docket No. 96-128
Provisions of the	)	
Telecommunications Act of 1996	)	

REPLY COMMENTS ON REMAND ISSUES

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July 27, 1998

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EXECUTIVE SUMMARY

The opponents of the Commission's avoided cost methodology provide no justification for the Commission to abandon its market-based approach to calculating per-call compensation. Certainly, commenters can provide no support for the claim that the D.C. Circuit rejected the Commission's approach -- as opposed to the Commission's explanation for that approach -- given that the court left the default rate in place and called simply for the Commission to provide a more adequate explanation of its avoided cost methodology. Nothing in the comments poses an obstacle to such an explanation.

I. The Coalition's Comments explained in detail why the economics underlying the Commission's avoided cost methodology are sound. Opponents of the avoided cost approach dispute this, claiming that the market for coin calls is not an appropriate surrogate for the coinless market. As the Coalition has already demonstrated, however, this claim is simply incorrect: because the same payphone is used to supply both local coin calling and access code and subscriber 800 calling, the markets are related in the relevant way. There can be no serious question, then, that the avoided cost approach is theoretically valid.

II. Several parties object that the payphone market does not function effectively, either because it is characterized by "locational monopolies" or because payphones do not accept pennies. Yet there is no empirical evidence and little in the way of argument to support either objection.

A. Parties have presented no empirical evidence to support the contention that locational monopolies affect the price charged in the market for payphone services. MCI and AT&T insist that there is competition only for the placement of phones, not for callers. But this argument rests on the preposterous claim that every payphone location -- every restaurant, retail store, street corner, and hotel lobby -- constitutes its own market for payphone services. The Coalition's expert economist explains that this proposition is absurd. Moreover, even in places where monopolistic pricing might be thought possible -- like airports -- there are frequently more than one PSP competing for the caller's business, as well as other factors that keep prices at competitive levels.

MCI concedes that no PSP is in a position to earn economic profits, but claims that location providers are able to charge monopoly commissions. That claim is untenable as a general matter. And, even if there were some locations where owners were able to exercise market power -- and no one has produced evidence that any owners are doing so -- that would not mean that the Commission should adjust the per-call compensation rate to account for this. As an initial matter, no party has even provided an estimate of the difference between the alleged "monopoly" commission rate and the competitive rate. Moreover, the location rent is a cost that PSPs must pay; if the Commission reduces per-call compensation, it will simply penalize local coin callers and reduce the deployment of payphones, contrary to the explicit command of Congress.

B. There is simply no reasoned support for the proposition that because payphones do not accept pennies, the price of a local call will tend to exceed costs. As the Coalition has shown, this claim is an economic canard -- indeed, even MCI's economists do not endorse it.

III. There is no evidence that the local coin rate diverges from costs. The fact that there is apparently little diversity in rates charged is consistent with a competitive market in payphone services, where price is set equal to a firm's costs. The fact that IXCs' cost studies produced per-call costs below the local coin rate -- while studies by PSPs tend to show even average costs exceeding the local coin rate -- simply emphasizes the inaccuracy of such cost accounting. If prices were in fact greatly in excess of costs, the supply of payphones would be rapidly increasing. As parties to the proceeding have conceded, this is not the case.

IV. Support for a calling party pays compensation mechanism -- a mechanism that the Commission has properly rejected -- demonstrates the general acceptance of market-based pricing. Indeed, support for calling party pays necessarily implies acceptance of the proposition that the market for payphone services is effectively competitive; those commenters who contend that competition for callers to access code and subscriber 800 numbers would effectively constrain the price indirectly concede that the same effective competition constrains the deregulated local coin rate. This concession underlines the validity of the avoided cost pricing technique.

V. Calling party pays does not, however, provide a viable, alternative market-based approach to per-call compensation. TOCSIA prohibits PSPs from requiring an advance deposit for an access code call -- including 800-access-code calls. Moreover, calling party pays would inconvenience callers and would tend to suppress call volumes. Finally, the claim that only calling party pays can effectively constrain rates is wrong -- the rate PSPs may charge is constrained both by competition in the market for local coin calls (a "calling party pays" market) and by IXCs' ability to block calls from payphones.

**BEFORE THE
FEDERAL COMMUNICATIONS COMMISSION
WASHINGTON, D.C.**

In the Matter of

Implementation of the Pay Telephone	)
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Provisions of the	)
Telecommunications Act of 1996	)

REPLY COMMENTS ON REMAND ISSUES

The RBOC/GTE/SNET Payphone Coalition (the "Coalition") hereby replies to comments filed in response to the Commission's June 19, 1998, Public Notice, DA 98-1198 ("Remand Notice").

INTRODUCTION

The Commission's Remand Notice appropriately focused on developing an adequate justification for the derivation of a market-based, default compensation rate for coinless calls. As the Coalition pointed out in its opening Comments, the D.C. Circuit did not reject the Commission's avoided cost methodology, but rather called for a more adequate explanation of that methodology. Indeed, few parties to the proceeding attempt to argue that the D.C. Circuit foreclosed the Commission's approach. But see Comments of the Consumer-Business Coalition at 4 ("CBC Comments"). Nor could anyone persuasively argue that the Commission's approach has been rejected, for the court left the default rate in place and called merely for the Commission to provide a more adequate explanation of its approach. See MCI Telecommunications Corp. v. FCC, 143 F.3d 606 (D.C. Cir. 1998), slip op. at 5-6 ("Payphones II").

The Coalition's Comments accordingly demonstrated, step by step, that because competition in the market for local coin calls ensures that the price of such calls will reflect their costs, the Commission's avoided cost methodology ensures that the per-call default rate, too, will reflect the costs of coinless calls, thereby replicating the results of a competitive market.

The opponents of the Commission's avoided cost pricing methodology raise predictable objections to the Commission's approach. They claim that the coin market is not an appropriate surrogate for the coinless market; that the market for local coin calling is not competitive; and that the Commission should price payphone services based on some measure of costs. None of these points is correct, and nothing in the record supports them. The Commission should, therefore, carefully but firmly reject each of these claims.

Perhaps the most striking theme to emerge from the comments, however, is the support for a calling party pays compensation mechanism. This support is significant, because it demonstrates the widespread acceptance of the proposition that competition for callers effectively constrains prices for payphone services. Such support, moreover, necessarily implies that the local coin rate reflects effective competition, and therefore indirectly (if unintentionally) endorses the Commission's avoided cost approach.

In deregulating the market for payphone services, the Commission has pursued an innovative, market-based approach to per-call compensation, an approach that has a solid foundation in economics and policy. None of the comments filed two weeks ago justify a departure from the Commission's avoided cost approach to setting the default compensation rate for dial-around, subscriber 800, and otherwise uncompensated toll calls from payphones. The

Commission should accordingly reaffirm its avoided cost approach and provide the explanation that the court has requested.

DISCUSSION

I. THE COMMISSION'S AVOIDED COST APPROACH IS THEORETICALLY SOUND

The economics underlying the Commission's avoided cost pricing methodology are relatively straightforward. In a competitive market, price reflects suppliers' costs. Where a single facility is used to provide more than one service -- as in the case of a payphone -- the price of each service will reflect its own incremental or marginal cost plus some portion of the common costs of the facility. By subtracting from the competitively determined local coin rate those costs uniquely associated with coin calls, and adding those costs uniquely associated with coinless calls, the Commission can ensure that the default rate for coinless calls will reflect the costs of those calls, including a portion of joint and common costs. As three eminent economists explained, this is a valid and effective regulatory technique for reproducing the results of free competition. See Coalition Comments at 14-15.

A. The Coin and Coinless Markets Are Related in the Relevant Way -- On the Supply Side

Several parties to this proceeding argue that avoided cost pricing is invalid because the markets for coin calling and coinless calling are different. See Comments of the Competitive Telecommunications Association[1] at 13-14 ("CompTel Comments") ("[T]he local coin and coinless markets are substantially different, with different actors and market dynamics for each.

[1]The Comments of LCI International Telecom Corp. and the Comments of Cable & Wireless, Inc. are just regurgitations of the CompTel Comments. The Coalition therefore refers exclusively to the Comments of CompTel, which are the most comprehensive.

These differences preclude the use of the local coin rate as a surrogate for coinless compensation rates."); Paging Network, Inc.'s Comments on Remand Issues at 7-10 ("PageNet Comments") (local coin calls, subscriber 800 calls, and access code calls are all in different markets); Comments of SkyTel Communications, Inc. at 4 ("SkyTel Comments"); Comments of Sprint Corporation at 18-19 ("Sprint Comments"); AT&T Comments at 7-12; MCI Comments at 5-6.

This argument is misguided. While commenters offer a litany of supposed differences in the "dynamics" of the market on the demand side -- e.g., the buyer is the caller in one case, while in another the buyer is the recipient of the call -- the relevant fact is that on the supply side the various categories of calls are common products, supplied by the same facility. See Coalition Comments at 17-18. Supply substitution, not demand substitution, is what is critical to an avoided cost analysis. "[I]f the market price of [a local coin call] may properly be regarded as reflecting the costs of supplying it, so may the regulated price of [coinless calls] be based on that same market price, provided only that it is adjusted for any differences in their several costs, as the FCC has attempted to do." Coalition Comments, Kahn Decl. at 4-5.

B. Avoided Cost Pricing Ensures That Competition in the Local Coin Market Will Constrain the Per-Call Default Rate

AT&T and others harp on the fact that purchasers of payphone services for access code and subscriber 800 calls have inadequate motivation to constrain the price of coinless payphone services because callers do not deposit coins in the box. See AT&T Comments at 8-10; CompTel Comments at 13-15. In fact, callers often do bear directly the costs of payphone services, even for coinless calls -- calling card callers pay a clearly identified charge on their bills; subscribers to voice mail services that use subscriber 800 numbers may also see the charge reflected on their statements. Moreover, IXCs and their subscribers can block payphone calls (though they generally do not because, for all their grousing, they consider the payphone services worth the price). See infra at 27-28. More fundamentally, however, the claim ignores the rationale for avoided cost pricing and is, therefore, beside the point.

The reason an avoided cost approach is necessary is that the market for payphone services for access code and subscriber 800 calls cannot function directly because of TOCSIA and the FCC's regulations. PSPs are barred from blocking access code calls, including calls to 800-access-code numbers; absent regulatory intervention, payphone providers would be uncompensated for calls to access code and 800 numbers. The Commission identified the local coin market as an appropriate surrogate for the coinless market not because the "market dynamics" are identical, but because the competitive price of a local coin call is an appropriate measure of the costs of a local coin call. Because the net differences in the incremental costs of coin calls and coinless calls can be fairly estimated, avoided cost pricing yields a default per-call compensation rate that mirrors the costs of coinless calls, including a share of joint and common costs. That default rate is, therefore, both efficient and fair. See Coalition Comments at 12-17.

AT&T also argues that once the default rate is allowed to float, payphone providers will have an incentive to raise prices "for the sole purpose of increasing their compensation for carriers for coinless calls." AT&T Comments at 11-12. This argument does not hold water: because local coin calling accounts for two-thirds or more of payphone calls, an increase in the local coin rate above the competitive rate would likely depress local coin revenues more than any corresponding increase in dial-around revenues.[2]

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[2]It is interesting that AT&T apparently assumes that demand for access code and subscriber 800 calls from payphones is highly inelastic. AT&T thus inadvertently endorses the Coalition's view that it would be efficient to account for such demand conditions by allocating a

C. The Market Price for Coin Calls Includes a Flat Charge for Payphone Access

PageNet's argues that longer calls should be priced at a higher rate than shorter calls. See PageNet Comments at 10; see also SkyTel Comments at 3-4; Comments of Pocket Science Inc.. Contrary to PageNet's unsupported claim, however, there is simply no information in the record of this proceeding to indicate the relative lengths of various categories of calls. PageNet argues that it is disadvantaged because calls to its 800 numbers tend to be shorter than the average subscriber 800 call; but it has no legitimate cause for complaint. The price of a 30-second subscriber 800 call is based on the competitive price for a local call of the same length.[3] The market has set a price for access to payphone services, in other words, that includes a flat charge.

Indeed, the fact that the Commission did not include a premium for longer calls disadvantages PSPs, as many PSPs do charge an incremental fee for local calls longer than a certain length. See Coalition Comments at 10; see also Coalition Comments, Becker Decl. at 7 n.3. Because many access code and subscriber 800 calls may be longer than the initial period of a local coin call, the Commission's flat charge can only be to the advantage of the IXCs. If IXCs -- in response to the evident wishes of at least some of their customers -- wish to discuss minute-of-use pricing for compensable calls, they are certainly free to raise that issue in their negotiations with PSPs.

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larger proportion of the joint and common costs of the payphone to calls eligible for per-call compensation and increase the default compensation rate above the local coin rate. See Coalition Comments at 10-12.

[3]Moreover, though calls to paging subscribers' numbers may tend to be short, they may also place a disproportionate burden on the payphones from which they are made. In the rare case where a person has placed a page from a payphone, that individual may prevent others from using the payphone in the expectation of a return call in response to the page. Moreover, the PSP will receive no compensation for that incoming call, which may be quite long.

II. THE LOCAL COIN MARKET IS EFFECTIVELY COMPETITIVE

The Coalition -- backed up by the analysis of expert economists -- has shown that the Commission was right to conclude that the market for payphone services is competitive, both in structure and in fact. See Coalition Comments at 17-25. The APCC, relying on two other experts in the economics of telecommunications, also supports the Commission's conclusions. See Comments of the American Public Communications Council at 4-7 ("APCC Comments"). Some commenters attempt to argue that the market for local coin calls does not function effectively for two reasons: the market is beset by "locational monopolies," and payphones do not accept pennies. Neither objection bears up to scrutiny.

A. The Locational Monopoly Objection Is Empirically Unsupported and Theoretically Misguided

In its First Report and Order, the Commission noted that there may be instances "where the size of the location or the caller's lack of time to identify potential substitute payphones" poses a potential barrier to effective market function. The Commission termed such instances "locational monopolies." See 11 FCC Rcd at 20573, ¶ 61.[4] The Commission concluded that such instances were likely to be the exception, rather than the rule; in most cases, the existence of another payphone nearby, the caller's ability to defer the call, or the availability of other substitutes for the payphone -- such as wireless phones -- require the payphone provider to set the local coin rate at a competitive price.

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[4]First Report and Order, Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, 11 FCC Rcd 20541 (1996) ("First Report and Order").

Several commenters claim that locational monopolies are in fact widespread. See e.g., Comments of the International Telecard Association at 4 ("ITA Comments"); Comments of Vocall Communications Corp. et al. at 5 ("Vocall Comments"); CBC Comments at 3 ("providers do not compete for customers on a point of sale basis"). But nothing in the record of this proceeding supports these claims. Indeed, there is no indication that the price of local coin calls in any location reflects a provider's market power. No party has presented a single example of a location where the price of a local call exceeds the prevailing market price. To the contrary, CompTel and AT&T insist that prices are uniform, as one would expect in a competitive market. See Reply Declaration of Professor Alfred E. Kahn at 7-8 ("Kahn Reply Decl.") (attached hereto as Exhibit A) ("the essence of competitive markets is to force the same price on all suppliers within that market"). This is the first in a series of "dogs that do not bark": IXCs and the rest have ample motivation to identify locations where payphone prices are above the competitive level and bring them to the attention of the Commission. They have not done so because they cannot. Moreover, the Commission has invited states to identify instances of market failure that would justify re-regulation of the local coin rate. See First Report and Order, 11 FCC Rcd at 20572-73, ¶ 61. No state has accepted the invitation.

Unable to point to a single case where a PSP has raised prices above the prevailing competitive rate, some commenters instead claim that all payphones are locational monopolies. AT&T, for instance, argues that there is no competition for callers, only "a battle among PSPs for the right to be the exclusive provider of payphone services at individual locations." AT&T Comments at 2. MCI refers to this situation as "competition-for-the-field." MCI Comments at 2; see MCI Comments, E Group Study at 2.

But for this analysis to be correct, every payphone location -- every street corner, every retail store, every restaurant, every hotel lobby -- would have to be a separate market for payphone services. Indeed, the E Group actually does suggest that each payphone location is a separate geographic market. See MCI Comments, E Group Study at 10. As Professor Kahn explains, this claim is "surely absurd." See Kahn Reply Decl. at 6. See also APCC Comments, Haring & Rohlfs Affidavit ¶¶ 11, 12. It is facially implausible -- and contrary to all the laws of economics -- to suggest that payphones users, unlike consumers generally, will not respond to a price increase by one provider by seeking an alternative source of supply. The APCC points out that a full 30 percent of payphones in the Austin, Texas, area are actually within sight of another. APCC Comments at 4. Even more frequently, a caller will know that an alternative payphone is around the corner, or outside the door. The E Group's suggestion that these known and proximate alternatives will not constrain prices is both incredible on its face and wholly devoid of record support. The E Group's analysis is tantamount to claiming that all fast food prices are set at a monopoly level, because McDonald's, Burger King, and the rest compete for the right to place outlets at attractive locations. Needless to say, such a claim would be obviously false. See also Kahn Reply Decl. at 1 ("At the conceptual level, the [E Group's] argument is dismayingly muddled.").

Even in airports, callers frequently have a choice -- and not simply a choice of wireless calling, or deferring a call for later. In major airports, there are frequently at least two PSPs.

Because there is competition in such locations between PSPs, each has the proper incentives to set a competitive market price.[5]

The ease of access to alternative payphones -- not to mention the possibility of deferring a call or using a wireless alternative -- gives the lie to claims that PSPs or location providers would be able to charge a monopoly price. Because payphone callers can choose another payphone, each PSP must charge the market rate or see a fall in demand. And because location providers are paid on a commission basis, they have no incentive to attempt to force PSPs to charge an uncompetitive price.

The E Group suggests that the recent increase in the prevailing coin rate from $.25 to $.35 is itself proof of market power because all payphone locations were "by definition, already profitable." MCI Comments, E Group Study at 11. This proves only that the E Group is embarrassingly ignorant of the market they purport to analyze. Prior to the deregulation of payphones in 1997, state officials kept local coin rates artificially low, and LEC PSPs were frequently required to maintain payphones at unprofitable locations. For this reason, independent PSPs could operate only in those locations where call volumes were significantly above the norm. The recent increases in local coin rates are simply a reflection of the fact that market forces have finally been allowed to work (and are working). And, despite those increases, the number of Coalition payphones has actually declined somewhat, a sure sign that the local coin rate is not inflated. See pp.18-19, infra.

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[5]As the Coalition has explained, the only plausible candidates for "locational monopoly" are facilities controlled by states and municipalities. Coalition Comments at 23-24. See also APCC Comments, Haring & Rohlfs Affidavit at ¶ 12. Such authorities are subject to political pressure to maintain payphone prices at market levels.

Nor is there merit to the argument that, because PSPs pay a competitive commission to location providers, PSPs ipso facto have market power. See AT&T Comments at 3. Plainly, space in an airport, on a street, or in a retail establishment can be put to many uses. PSPs' payments to location providers are no more surprising than the rental payments paid by any business, and no more indicative of market power, either on the part of the landlord or the tenant. As the Coalition has already pointed out, the fact that rents are higher on Fifth Avenue in Manhattan than in rural Mississippi does not mean that a Fifth Avenue landlord has market power.

Even assuming -- contrary to all available evidence -- that there are some locations where payphone rates could be profitably raised above the prevailing market price, that still would not mean that PSPs have any market power. Even the most tenacious opponents of the Commission's avoided cost approach do not claim that the payphone market is characterized by any barriers to entry. Indeed, MCI, while insisting that location owners have market power, concedes that PSPs do not, but instead must compete for the right to provide a payphone. As MCI's expert concludes, this means that "each payphone firm will earn a zero economic profit" -- in other words, that the rates charged by PSPs converge with PSPs' costs. See MCI Comments, E Group Study at 6. Other parties, too, back up the Commission's determination that there are "low payphone entry barriers." Comments of Allen Lund Co., et al. at 1. Nor was the Coalition alone in providing expert testimony confirming the competitiveness of the market for payphone services. The expert evaluation submitted by the APCC confirmed that "the payphone industry is one characterized by low economic barriers to entry." APCC Comments, Haring & Rohlfs Declaration ¶ 8.

For this reason, any hypothetical monopoly returns to be extracted as a result of "locational monopoly" would accrue to the location provider -- not the PSP. Yet no one has given any hint as to what portion of the commissions paid to location providers reflects such market power, or even suggested how such a calculation could be carried out. And such rents would hardly justify regulation in any event, as AT&T concedes: "the Commission does not have the authority to affect the property rights of location owners." AT&T Comments at 5.

Moreover, if the Commission were to reduce payphone compensation to adjust for the possibility that some location providers have market power in the payphone market, the result would be a sharp decline both in the deployment of payphones and in social welfare. That is because -- as every analyst of the market agrees -- competitive entry in the payphone market means that all payphone firms predictably operate at cost. If per-call compensation is artificially depressed below the derived market rate out of a misplaced concern about locational monopolies, payphone firms would be forced to remove payphones with below-average volumes, reducing payphone deployment. The resulting shortage in payphone services will harm the public, and PSPs, while likely having little impact on location providers' supposed monopoly rents.

B. There Is No Support for the Five-Cent Increment Objection

A few parties half-heartedly rise to the Commission's bait, and claim that the fact that payphones do not accept pennies means that the market is not effectively competitive. See, e.g., MCI Comments at 5; Vocall Comments at 5. But the claim has no basis in economic theory or practical reality, and no reputable economist has endorsed it -- even the "E Group" is conspicuously silent on this issue.

MCI argues that, "even if the local coin market otherwise functioned perfectly, if the rate at which that market would come to rest is a rate ending in 1 through 4, the coin rate could not equal the cost." MCI Comments at 5. Nonsense. Under conditions of free entry, the supply of payphones will expand (or contract) until the costs of a marginal payphone are equal to the competitive market price. See Coalition Comments at 26; id., Becker Decl. ¶ 38. Nor is any incremental pricing intrinsically more likely to make the prevailing rate higher or lower than it would otherwise be: MCI does not and cannot justify the implicit claim that the rounding to the nearest nickel would, on average, be upward rather than downward. See Coalition Comments at 26; id., Kahn Decl. at 15.

III. THERE IS NO EVIDENCE THAT THE LOCAL COIN RATE EXCEEDS COSTS

There is no dispute on the record that entry into the payphone market is easy and that competition among PSPs drives firms' economic profits -- that is, return in excess of the cost of capital -- to zero. There can, therefore, be no serious question that the price of payphone services, including the price of a local call, reflects PSPs' costs.[6]

Commenters nonetheless attempt to raise such questions by making two points. First, they claim that the uniformity in local coin rates suggests that payphone rates do not reflect cost differences among payphone locations. Second, they cite various cost studies in the record of this proceeding that allegedly support the claim that local coin prices exceed costs. Neither argument is valid.

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[6]As MCI concedes, this is true even if there are some locations where there is no effective competition for payphone users, because any economic profits to be earned will accrue to location providers, not PSPs. For the reasons discussed, however, locational rental payments are unlikely to reflect market power, but rather the economic value of the property. See Kahn Reply Decl. at 1-4.

1. CompTel argues that "[i]f costs and rates converged in the local coin market, . . . one would expect significant variances in the local coin rate . . . . by geography, by density of payphones, and by PSP." CompTel Comments at 11-12.[7] As an initial matter, CompTel is wrong to suggest that uniform pricing is inconsistent with competitive markets. To the contrary, in competitive markets, all firms will be price takers, and will be able to charge only the prevailing market rate. See Kahn Reply Decl. at 8. Prices should not, in other words, vary by PSP.[8]

Nor would prices necessarily vary within a PSP depending upon the geographic location. Firm-wide, the price of the payphone service will reflect the average cost of such service. See Hausman Decl. ¶ 6 ("[I]n a competitive market . . . with free entry, price equals average total cost."); see also MCI Comments, E Group Study at 6 ("each payphone firm will earn a zero economic profit") (emphasis added). In the long run, it is entirely possible that greater variation in payphone pricing will emerge, as PSPs jostle for advantage in the marketplace, but the current uniformity in pricing is entirely consistent with a fully competitive market. See Kahn Reply Decl at 8. Thus, McDonald's charges uniform prices for a Happy Meal throughout the country, notwithstanding the sometimes significant variations in rental costs, labor costs, and distribution costs. But no one suggests that the fast food market is anything but intensely competitive.

2. Numerous commenters rely on cost data in the record -- and, in the case of MCI, yet another cost study -- to argue that the $.35 local coin rate exceeds payphone costs. The argument

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[7]PageNet's Comments include the same point in similar language.

[8]Indeed, as previously noted, the relative uniformity of payphone pricing is inconsistent with the proposition that individual payphone locations reflect market power -- for a local monopolist would be a price setter, and individual payphones would thus tend to charge widely varying prices.

simply proves that the cost accounting methods used to develop such data are unreliable, and that the Commission was wise to reject calls for setting a cost-based rate.

Cost information submitted in this proceeding has landed all over the map. Independent payphone providers ("IPPs") have reported average costs of nearly $.40 per call for all calls. See Second Report and Order,[9] 13 FCC Rcd at 1799, ¶ 49. These data merit particular attention, because IPPs have operated as stand-alone, deregulated entities for years, not months. Indeed, MCI's own economic experts cite data indicating that People's monthly per-payphone revenues -- which are expected to approximate costs, according to the E Group -- are $280, or $.40 per call, even using MCI's inflated estimate of 700 calls per phone.

The Commission's own analysis of cost data -- based on data provided by the Coalition, by IPPs, and, most of all, by AT&T -- showed a bottoms-up cost of coin payphone service between $.313 and $.347 per call. See Second Report and Order, 13 FCC Rcd at 1824, ¶ 108 (adjusted for avoided costs of $.066 per call). This figure, however, ignored commission payments completely. Moreover, an Andersen study showed that the data analyzed by the Commission were actually consistent with a per-call cost figure of nearly $.38 for coinless calls. See Coalition Petition for Reconsideration, Andersen Report at 13 (filed Dec. 1, 1997).

Not surprisingly, opponents of market-based pricing ignore such data and instead suggest that the Commission should rely on lower cost estimates. For example, many parties rely on a NYNEX study -- not in the record -- that purportedly showed local coin call costs of $.167 per call. See Sprint Comments at 16; Comments of the Personal Communications Industry

[9]Second Report and Order, Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, 13 FCC Rcd 1778 (1997) ("Second Report and Order").

Association at 6 ("PCIA Comments); PageNet Comments at 12; AT&T Comments at 17. None of these commenters comes to grips with the fact that the NYNEX study did not represent total per-call costs, but was instead an incremental cost study, and was not even representative of costs incurred by other payphone operations. See Coalition Reply Comments on Remand at 26-27; Andersen Remand Reply Report at 3-4.

The New York PUC similarly relies on an incremental cost study to argue that payphone costs are under $.25 per call; for the reasons the Commission has already explained, it is inappropriate to rely on strictly incremental costs for purposes of estimating the actual costs incurred by a competitive PSP.[10] See First Report and Order, 11 FCC Rcd 20576, ¶ 68 ("use of a purely incremental cost standard for all calls could leave PSPs without fair compensation for certain types of payphone calls"); Order on Recon.,[11] 11 FCC Rcd at 21266-67, ¶ 66. Ignoring the Commission's earlier rulings completely, several other parties renew calls for the Commission to set a price based on purely incremental costs of access code and subscriber 800 calls. See Vocall Comments at 6; Comments of IXC Communications Services, Inc. at 1-2

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[10]Andersen has examined the confidential cost study to which the New York PUC refers and has determined that it does not provide a fair representation of PSPs actual costs for two reasons. First, it is an incremental cost study that is not representative of total payphone costs. Second, the New York study was not representative of the costs of operating in a deregulated environment. See Critique of Incremental Payphone Cost Studies at 6-7 ("Andersen Reply Decl.") (attached hereto as Exhibit B). Thus the NYNEX study was designed to determine whether a particular LEC's payphone service, when regulated, had been subsidized by other basic exchange or exchange access rates. It did not demonstrate the actual costs that the LEC faces in providing payphone service as a competitive PSP.

[11]Order on Reconsideration, Implementation of the Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996, 11 FCC Rcd 21233 (1996) ("Order on Recon.").

("IXC Comments");[12] CBC Comments at 4; Comments of AirTouch Paging at 6 ("AirTouch Comments").

Other parties rely on cost studies by various IXCs to support per-call incremental costs for coinless calls of anywhere from \$.06 to \$.15 per call. See ITA Comments at 6; Comments of Excel Communications, Inc. at 11 ("Excel Comments"). The Coalition has refuted these studies in detail elsewhere. See Coalition Reply Comments on Remand, Andersen Remand Reply Affidavit (FCC filed Sept. 9, 1997); Reply Comments of the RBOC Payphone Coalition; Andersen Reply Affidavit (filed July 15, 1996). Andersen's careful analysis shows that such studies, properly adjusted, are entirely consistent with an actual per-call cost figure well in excess of \$.35. Likewise, Andersen's analysis of proprietary data from SBC -- released by AT&T -- show that such data, adjusted to account for operations in a deregulated environment, suggest that average fully loaded costs of those phones again exceeds \$.35 per call. See Coalition Opposition to Petitions for Reconsideration, Andersen Report at 7 (FCC filed Jan. 7, 1998); Cf. Sprint Comments at 17-18; Excel Comments at 10-11.

MCI's latest cost study once again brings the weaknesses of such efforts into sharp relief. See MCI Comments, Exhibit 2. As an initial matter, MCI assumed that the average payphone has a call volume of 700 calls per month. Id., Exhibit 2 at 1. The average Coalition phone has a volume of about 480 calls. See Andersen Reply Decl. at 2. The use of 700 calls, in other words, would tend to drive many -- if not most -- Coalition payphones out of the market. Adjustment for call volumes, alone, would increase the per-call cost of a smart payphone in MCI's study by

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[12] IXC Communications, which attempts to rely on the economic teaching of Professor Kahn, see IXC Comments at 2, will presumably find Professor Kahn's explanation of precisely why its arguments are wrong particularly helpful.

nearly 50 percent.[13] The errors, however, do not stop there: MCI has again included only incremental costs, rather than examining all actual per-call costs, ignoring fixed overhead expenses and certain software costs, for example. The treatment of payphone and enclosure costs understates these costs and is inconsistent with data in the record. And certain types of capital costs are ignored altogether. The study also ignores costs unique to per-call-compensation-eligible calls. The attached analysis by Arthur Andersen explains these errors in detail, and shows that the MCI study actually supports a per-call cost for all calls in excess of \$.35. See Andersen Reply Decl. at 6.

In short, while the cost data submitted to the Commission may contain "something for everyone," any objective evaluation of those data indicate that they are fully consistent with per-call costs of \$.35 for local coin calls. They do not show that the price of a local call exceeds costs.

Instead, the continued calls for a cost-based rate making simply emphasize the point that the Coalition has made most recently in its Comments: such a cost-based procedure would be administratively burdensome,[14] inaccurate, and subjective. See Coalition Comments at 3-5. To arrive at a marginal per-call cost for payphone services in a bottom-up calculation, the Commission must determine -- through administrative fiat -- what the minimum volume for a

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[13]Moreover, if one were to use the average volume of calls, one must include average commissions in the cost calculation. Exclusion of commission costs can be justified -- if ever -- only by reference to marginal, rather than average, call volume.

[14]PCIA, for its part, insists that with all the data on the record, the Commission's cost data are still inadequate, and would apparently have the Commission engage in further administrative proceedings to determine such costs. PCIA Comments at 3.

payphone location "should" be.[15] The Commission is absolutely correct to leave that determination to the interplay of demand and supply in the market. When different parties' estimates of costs vary by a factor of five or more, the claim that cost-based rate making "avoids faulty guesswork and assumptions inherent in attempting to set a 'market rate,'" Excel Comments at 11, is simply laughable.

Finally, the record contains entirely persuasive evidence that local coin prices do approximate costs: as CompTel observes, there has been no appreciable increase in the supply of payphones since prices were deregulated, despite the increase in local coin rates. CompTel Comments at 10-11. Indeed, the supply of RBOC payphones has dropped slightly. See Coalition Comments, Andersen Report at 10 (showing a 1.3% drop in Coalition payphones between 1996 and 1997); see also Letter from Michael K. Kellogg to Rose M. Crellin, Apr. 20, 1998 (showing a 1.3% drop in RBOC dumb payphones between October 1997 and March 1998). This pattern is entirely consistent with an industry where deregulation has led to an increase in price without any possibility of economic profit. See Kahn Reply Decl. at 4-5. This is, then, another dog that has not barked: if prices in the industry significantly exceeded industry costs, in the absence of entry barriers one would expect significant increases in supply. The fact that such entry has not been observed proves that the competitive price is consistent with costs.

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[15]In the case of avoided cost pricing, only the adjustment to the market price depends on the administratively determined call volume. The effect of errors is therefore muted. Moreover, if the Commission corrects the errors in its avoided cost calculation, the adjustment to the coin price works out to about zero, and the call volume at a marginal phone will be irrelevant to the final calculation of the default per-call rate.